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IN THE

Supreme Court of The United States

October Term, 1969

NO. 402

UNITED STATES OF AMERICA,

Petitioner,

v.

SHELDON A. KEY, TRUSTEE,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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OPINIONS BELOW

Although there was no formal opinion of the District Court, the order of the District Court dated December 19, 1967, confirming the respondent's amended plan of reorganization is set forth in the petition as Appendix C p. 10a. The opinion of the United States Court of Appeals for the Seventh Circuit is reported in 407 F. 2d 635 (1969). It affirmed the ruling of the District Court.

JURISDICTION

The Petitioner is invoking the jurisdiction of this Court under 28 U.S.C. Sec. 1254 (1). As set forth in Rule 19 of the Supreme Court of the United States, "a review on writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons therefor."

QUESTIONS PRESENTED

Did the District Court for the Southern District of Indiana, Indianapolis Division, and the Seventh Circuit Court of Appeals err in holding that Section 199 of the Bankruptcy Acts does not vest in the Secretary of the Treasury the authority to defeat a plan by written rejection where such plan provides for payment of the Government's Tax claim without interest, and also provides the Government with a security interest in contract rights of the debtor valued in excess of its claim?

STATUTES INVOLVED

The pertinent provisions of the Bankruptcy Act, as amended, are Sections 199, 216, 221 and 236. The only statute involved in addition to the Bankruptcy Act is Revised Statute, Sec. 3466. The statutory provisions are set forth at pages 16a to 18a of the petition with the exception of Sec. 236 of the Bankruptcy Act which appears in The Appendix *infra*. page A-1.

STATEMENT OF THE CASE

The Petitioner seeks this court's review of a decision of the United States Court of Appeals for the Seventh Circuit affirming an order of the United States District Court for

the Southern District of Indiana, Indianapolis Division, confirming an amended plan of reorganization submitted by Sheldon A. Key, Trustee, under Chapter X of the Bankruptcy Act. The material facts may be summarized as follows:

The debtor filed its voluntary petition in the District Court for a reorganization under Chapter X of the Bankruptcy Act, on May 3, 1954, as a general commodity carrier operating by authorization of the Interstate Commerce Commission over a network of regular routes extending through the states of Wisconsin, Missouri, Illinois, Kentucky, Indiana, Pennsylvania, Ohio and Michigan.

The trustee's plan of reorganization as modified was confirmed on January 31, 1957. The plan provided for payment in full or part of claims totalling in excess of $1,500,000, including the claim of the United States for taxes totalling $411,458.06. The claim of the United States was to be paid in installments over a four year period. Wage claims and secured creditors were paid in cash in full. Unsecured creditors received a choice of cash settlements, extended payments or stock.

On June 1, 1958, the property and assets in possession of the trustee were vested in the reorganized debtor corporation, and the cash and shares of stock provided for under the plan were paid out as designated to the creditors involved therein.

On December 6, 1961, the trustee filed his petition to declare the plan of reorganization substantially consummated and to direct a filing of his final report. At that time all claims in the proceeding had been adjudicated. The claim of the United States had been paid down pursuant to the plan, to a balance of $181,563.33, inclusive of principal and interest.

At or about the same time the reorganized debtor had entered into negotiations with Hennis Freight Lines, Inc. (hereinafter referred to as "Hennis"), a general commodity carrier doing business mainly between the southern states and New York, Philadelphia, and New Jersey industrial centers, for a sale of its certificate of convenience and necessity issued by the Interstate Commerce Commission. On February 15, 1962, an agreement of sale was entered into between the parties providing for a sale of the Hancock operating rights to Hennis for the sum of $1 Million, inclusive of principal and interest, payable $300,000 within 90 days of approval and the balance in 78 equal monthly installments. The contract also provided in the event of cancellation of a portion of the Hancock operating rights by the Interstate Commerce Commission for a reduction in the purchase price in direct ratio to the number of miles embraced in the cancelled rights. Pending the approval of sale by the Interstate Commerce Commission Hennis agreed to lease the operating rights pursuant to temporary authority for the sum of $2,000.00 per month.

On March 5, 1962, before hearing on the trustee's petition was held, three creditors whose claims had arisen subsequent to June 1, 1958, filed a petition praying (1) that the plan of reorganization be amended to provide for payment of creditors whose obligations arose subsequent to the confirmation of the plan and (2) that the trustee be empowered to retake control and possession of the debtor. The petition alleged *inter alia* the insolvency of the reorganized debtor. On March 15, 1962, after due hearing, the district court entered its order revesting the trustee with title to the property of the debtor and directing the trustee to proceed as though Chapter X proceedings had commenced.

Among the claims filed with the trustee after he reassumed possession of the property and assets of the debtor was that of the Government in the total sum of $380,419.01, representing the balance due it under the plan confirmed in 1958 totalling $181,563.33, together with new liabilities incurred by the reorganized corporation, inclusive of principal and interest, totalling $197,975.40. The claim has since been reduced and allowed pursuant to stipulation in the sum of $375,396.55.

Subsequent to the return of the assets and property to the possession of the trustee, the district court entered its order on August 10, 1962, affirming the contract of sale between Hennis and the debtor involving the sale of the debtor's interstate operating rights and authorizing the trustee to take all steps necessary to consummate the sale.

The application under Section 5 of the Interstate Commerce Act was referred to a hearing examiner who submitted his report on August 15, 1964, recommending that the sale transaction be approved providing, however, for a modification imposing certain restrictions on shipments originating from and destined to Detroit, Michigan.

The Interstate Commerce Commission issued its order approving the hearing examiner's report on March 11, 1965.

The trustee filed suit in the district court to overrule the Interstate Commerce Commission. The three-judge court entered an order on January 12, 1967, sustaining the Interstate Commerce Commission.

Thereafter, Hennis insisted on a reduction in sale price pursuant to the terms of the contract. After extensive negotiations a modification of the original purchase agreement was entered into.

The modification provided for a purchase price to be paid by Hennis of $935,000 in lieu of the original $1 Million, payable as in the original agreement—$300,000 within 90 days of final approval and the balance of $635,000 by a note secured by a chattel mortgage on the operating rights payable in 78 equal monthly installments. The trustee agreed to submit a plan providing for payment of all administration and priority claims in full, without interest, and for settlement of all unsecured claims for 20% of the amounts due. The purchase price was to be further reduced by deducting therefrom any funds in excess of the amounts needed to satisfy the plan.

The proceeds from the sale of the operating rights under the modified agreement of sale, together with approximately $75,000 representing funds in the hands of the trustee, formed the means of execution under the trustee's amended plan of reorganization as filed on June 23, 1967. The amended plan of reorganization classified the United States as a Class 2 creditor providing payment for the United States and certain other state tax claimants as follows:

> ". . . (B)y the payment to said creditors of ten per cent (10%) of the amount of said claims, in cash, within six months from the date of confirmation of this plan of reorganization, and by payment of the balance of said indebtedness in full, exclusive of interest, in seventy-eight equal monthly installments, the first said installment to be paid within six months after confirmation of the plan. Said installment payments shall be secured by the assignment of note and chattel mortgage as hereinafter more explicitly set forth in the Means of Execution of this plan; and the rights of the creditors in the aforementioned classes shall be modified and altered accordingly".

There is no provision in the plan for any class of creditor to receive interest on its claim whatsoever.

Article VIII of the amended plan of reorganization provides security for the payment of the United States and other tax claimants by providing that Hennis will execute a note in an amount not to exceed $635,000 reduced by the amount in excess of the sum necessary to make the payments provided for under the plan. The actual amount of the note has now been fixed in the sum of $600,968.16, representing the total amount of the claims of the four tax creditors less the 10% to be paid on confirmation.[1] This note will be secured by a chattel mortgage on the operating rights. The aforementioned note and mortgage will be assigned by the debtor to a banking institution approved by the court as trustee for the benefit of the United States and the three other tax claimants. Hennis will make the prorated monthly payments totalling approximately $7,700 directly to the claimants rather than to the trustee.

In addition to providing for tax claimants and unsecured creditors, holders of claims for wages will be paid in cash within six months and the claims of various states for real and personal property taxes are to be paid within six months from the date of confirmation. No provision is made in the plan for stockholders, by reason of the insolvency of the debtor.

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[1] Class 2, United States $375,396.55
Class 3, State of Indiana, Gross Income Tax 31,218.91
Class 4, State of Indiana, Vanderburgh County 76,650.55
Class 5, State of Ohio, Highway Use Tax 184,486.39

$667,742.40
Less 10% 66,774.24

$600,968.16

On September 7, 1967, the petition for approval of the agreement modifying the 1962 contract for sale of the debtor's operating rights to Hennis and approval of the amended plan of reorganization were brought on for hearing simultaneously. The court, after hearing the trustee's witnesses, Jesse L. Phipps, Vice President of Hennis; Thomas W. Andrews, Vice President of McLean Trucking Company, Webster Division; and Sheldon A. Key, trustee, held that $935,000 was a fair price for the debtor's interstate operating rights and approved the agreement. The Government filed notice of rejecting the plan on November 20, 1967.

On December 19, 1967, the district court entered its order confirming the plan of reorganization. (Petitioner's Brief App. C, pp. 10a-15a).

ARGUMENT

The decision below is correct and not in direct conflict with any other decisions. Moreover, the issue presented is narrow and unique to the facts of this case and thus the question is not one of substantial importance to administration of bankruptcy reorganization proceedings.

To interpret the Seventh Circuit holding in this case as an impairment of the Petitioner's right to priority status in a Chapter X proceeding is a misconception. This misconception of the opinion of the Lower Court is the basis of the petition. The Petitioner goes to great lengths to argue that the Seventh Circuit erroneously decided that R. S. Sec. 3466 was inapplicable in Chapter X proceedings.

The Court's decision was based on the interpretation of Secs. 199, 216(7) and 221 of the Bankruptcy Act.

The Lower Court correctly held that Section 199 of the Act governed the nature of the Government's tax claim priority and related Sections 216(7) and 221 governed the method of payment.

For all intent and purpose in a corporate reorganization the priority granted by Sec. 199 is the same as that of R. S. Sec. 3466.

That portion of the opinion regarding the applicability of R. S. Section 3466 was not essential to the decision of the Lower Court and as such is *dictum*—correct *dictum,* but *dictum* nonetheless. This Court normally is not called upon to review *dictum* but this seems to be the crux of the Petitioner's argument.

In commenting on R. S. Section 3466, the Lower Court correctly reasoned if this section ". . . is applied to a

Chapter X plan, the 'fair and equitable' provisions of Sections 216(7)(d) and 221 are effectively contradicted." *In re Hancock Trucking Incorporated,* 407 F. 2d 635, 638 (CA-7, 1969). The Seventh Circuit's opinion continued:

> "Section 199 outlines the nature of the government's tax claim 'priority' and the two other sections establish an equitable standard to govern the method of payment."
>
> • • • • •
>
> "The specific provisions of Sections 199, 216 (7) (d) and 221 of Chapter X cannot be fairly construed to require, as a matter of law, that a plan insure the government total satisfaction of its tax claims *before* other creditors receive anything, as a condition precedent to the plans being 'fair and equitable'." *Ibid.*

Thus the Lower Court did not hold that Government was not entitled to priority status as a claimant. To the contrary, the Seventh Circuit went on to say that the plan contemplated that the Government's claim would be paid in full:

> "In the case at bar, the approved plan contemplates that the United States *will be paid in full,* and the record supports the trial court's conclusion that the plan affords reasonable protection to the government." *In re Hancock Trucking, Incorporated,* 407 F. 2d 635, 638 (CA-7, 1969). (Emphasis ours.)

The petitioner apparently infers that the absolute priority granted by either Sec. 199 of the Bankruptcy Act or R. S. Sec. 3466 implies an absolute veto power in the United States if its claims are not paid in cash immediately.

Thus, the petitioner claims that the opinion dealing with R. S. Section 3466 is in conflict with *United States v. Anderson,* 334 F. 2d 111 (CA-5, 1964) *cert. denied* 379

U. S. 879 (1964) and *In re Cherry Valley Homes, Inc.*, 225 F. 2d 706 (CA-3, 1958) *cert. denied sub nom DuBois v. United States,* 358 U. S. 864 (1958). The Petitoner, however, has overlooked the fact that neither one of these courts had before it the same question which is presented herein and upon which the Seventh Circuit rendered its opinion.

The Cherry Valley Homes Case involved a tax claim the Government had against "Tobin", a creditor of Cherry Valley Homes Inc., the debtor corporation. Cherry Valley owed Tobin a smaller amount than Tobin's tax indebtedness. The Government served Cherry Valley with appropriate process to levy on this claim six months prior to Cherry Valley's voluntary petition under Chapter X. The Fifth Circuit held that the levy would be treated as analogous to a seizure establishing priority for the Government over general creditors under Section 199 or as a lien creditor. The Court indicated in the alternative that this priority status would also exist by reason of R. S. 3466. There is no discussion in the opinion that the application of R. S. 3466 would grant the United States' claim for taxes any greater priority rights than it would otherwise have as a secured creditor.

The Lower Court itself distinguished the *Anderson Case, supra,* as follows:

> "A case in which the court did apply Section 3466 to a Chapter X matter is United States v. Anderson 334 F. 2d 111 (5th Cir. 1964). By a divided Court, the Court of Appeals for the fifth circuit decided that the government's *non-tax* debts were to have priority. However, the Court did not specify whether such non-tax claims were entitled to 'payment in full' or to 'first satisfaction'." *In re Hancock Trucking Incorporated,* 407 F. 2d 635, 638 (CA-7, 1969).

In the *Anderson Case* claims of the Maritime Administration, Small Business Administration, Department of the Navy and Post Office Department were denied priority status in the plan of reorganization. The Fifth Circuit held that such claims of the United States were accorded priority status under R. S. Section 3466. The Court went on to say that R. S. 3466 and Section 199 were not inconsistent when an insolvent debtor was involved. The Fifth Circuit did not consider Section 199 in connection with related sections 216(7)(d) and 221, nor did it consider the manner in which payment of the priority claims was to be made.

The Petitioner's claim that the holding of the Lower Court is in conflict with the "absolute priority rule" set forth in *Northern Pacific Railway v. Boyd Lumber Co.*, 228 U.S. 482 (1912) is erroneous. On the contrary the decision of the Seventh Circuit adhered to the "rule of absolute priority" in its determination of the instant case. The Court reasoned that the Trustee's plan recognized and provided for "payment" of the principal amount of the Government's tax claims, required under Section 199. The plan required the Government to surrender no right it was legally entitled to and for which, under *Case v. Los Angeles Lumber Co.*, 308 U. S. 106 (1939) *rehearing denied*, 308 U.S. 637 (1939), and *Consolidated Rock Products Co. v. Dubois*, 312 U.S. 510 (1940) complete compensation must be provided. The plan provided that as soon as funds became available through installment payments by Hennis, these funds were immediately paid to tax claimants.

There is no provision of Chapter X which specifically prohibits, or has been interpreted as prohibiting, the payment of a dividend to lesser ranking creditors out of funds other than those allocated to satisfy the Government claim,

especially when such general creditors accept a lesser dividend in exchange for earlier payment.

It is an economic fact in the instant case that if confirmation of the plan were denied, the debtor would be forced to liquidate in a superseding bankruptcy proceeding. If that occurs, it can be assumed[2] general creditors would receive a minimum of 28% after 6 1/2 years instead of 20% and the Government's tax claim of $375,000 would be paid in full in 4 1/2 years *without interest.*[3]

The foregoing observation also aptly illustrates that acceptance of the plan by general creditors is in fact an agreement to scale down their claims. Compromise of claims by the trustee is proper throughout the proceeding. *Case v. Los Angeles Lumber Co., supra.* This important

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[2] In all probability the trustee in bankruptcy would not want to renegotiate the sale due to the lengthy proceeding to have the sale approved by the I. C. C. and the fact that the terms of the sale to Hennis have already been deemed "fair" by the Court.

[3] The calculation is based on cash in the hands of the trustee of $75,000; payments made by Hennis under the contract of purchase of $300,000 within 90 days and the balance of $635,000 in 78 monthly installments; costs of administration of $90,000 maximum; priority tax claims and wage claims Sec. 64(a) of $683,148.71 and general unsecured claims of $834,000.

Total Funds available		$1,010,000
Administration Expenses	$90,000	
Priority claims	684,000	
		774,000
Balance of		$ 236,000

For pro rata distribution to 834,000 or 28%

Under the installment plan it will be 4½ years before the $774,000 required to be paid to priority claimants is accumulated. As the costs of administration are decreased, the dividend to general creditors increases proportionately. If the costs of administration are $50,000 the dividend would be 32%. The general creditors would have to wait 6½ years for full payment.

facet of the case, raised in the Lower Court is ignored by the Petitioner in its argument that general creditors are being paid at the expense of the Government.

The Lower Court also followed the opinion of this Court in *City of New York v. Saper,* 336 U. S. 328 (1948) applied to Chapter X in *United States v. Edens,* 189 F. 2d 876 (CA-4, 1951) *aff'd per curiam* 342 U.S. 912 (1951) in rejecting the Government's argument for interest on the unpaid balance, i.e. the claim amounts to a demand for post-petition interest. The demand for interest in the case at bar was correctly reviewed as an attempt to circumvent the decision in the *Saper Case, supra.*

As to the Petitioner's argument that the decision of the Lower Court is in conflict with the decisions of this Court holding R. S. 3466 applicable to equity receivership proceedings, it is submitted that such receivership proceedings involved no rule of law comparable to Section 199, nor as we have pointed out is R. S. 3466 in conflict with Sec. 199.

Most important, any weight given to the decision must be greatly tempered by the unique facts in the instant case.

In the bulk of Chapter X cases when reorganization of a corporation fails, the debtor is liquidated in a superseding straight bankruptcy proceeding pursuant to Section 236 of the Act. *John Hancock Life Insurance Co. v. Casey,* 141 F. 2d 104, (CA-1, 1944) *cert. denied* 323 U.S. 713 (1944). This Court is cognizant that R. S. Sec. 3466 would be inapplicable in such cases. *United States v. Marxen,* 307 U.S. 200 (1938). The proposal of the 1967 amended plan was possible on the basis of primarily four factual facets of the case and the proposed plan:

(1) The length of the proceedings, commencing in 1954 had enabled the debtor to present one plan, march out of court, and agree to sell its asset (its interstate operating rights) for a substantial sum prior to the Reorganization Court re-acquiring jurisdiction in 1962.

(2) An agreement for a long term installment sale of the interstate operating rights was reached and a lengthy proceeding for approval was in the offing before the Interstate Commerce Commission when the Reorganization Court re-acquired jurisdiction; the conclusion of the case under Chapter X as opposed to straight bankruptcy was therefore desirable.

(3) The mechanics of the plan under which payment of tax claims, including the United States, is to be made involves a fund created by installment payments on the sale of the interstate rights, paid over a period of 6 1/2 years; payment being secured by a security interest in such rights.

(4) The unsecured creditors having claims totaling $834,000 agreed to accept a 20% cash dividend in lieu of awaiting final liquidation.

In further reviewing the facts surrounding the instant case this Court should consider the amount in dispute. The Government complains pertinaciously of a 6 1/2 year wait for full satisfaction of its claim, arguing that failure to pay interest on its claim during this period is "judicial denunciation" even though funds for this purpose are not available to the trustee. As heretofore indicated, if this estate were liquidated in straight bankruptcy, sufficient funds would not be available to satisfy the claim of the United States for 4 1/2 years (Fn 3 p. 13). Thus, the interest to which the United States would be entitled, if at all, would amount to no more than $6,492.00. Such is the disputed amount in the case the Petitioners would have

this Court review. Nor does this small amount represent any existing or potential class of similar claims.

CONCLUSION

For the foregoing reasons and authorities cited, the petition for writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Bankruptcy Act, c. 541, 30 Stat. 544 (as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840, 893):

Sec. 236. If no plan is proposed within the time fixed or extended by the judge, or if no plan proposed is approved by the judge and no further time is granted for the proposal of a plan, or if no plan approved by the judge is accepted within the time fixed or extended by the judge, or if confirmation of the plan is refused, or if a confirmed plan is not consumated, the judge shall—

(1) where the petition was filed under section 127 of this Act, enter an order dismissing the proceeding under this chapter and directing that the bankruptcy be proceeded with pursuant to the provisions of this Act; or

(2) where the petition was filed under section 128 of this Act, after hearing upon notice to the debtor, stockholders, creditors, indenture trustees, and such other persons as the judge may designate, enter an order either adjudging the debtor a bankrupt and directing that bankruptcy be proceeded with pursuant to the provisions of this Act, or dismissing the proceeding under this chapter, as in the opinion of the judge may be in the interests of the creditors and stockholders.

(11 U.S.C. 636)